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ECONOMIC INTELLIGENCE WEEKLY

23 July 1975

Overview

The OECD, in Its Just Released Economic Outlook, Is Uncommonly Pessimistic compared with its previous forecasts. Even though the Secretariat believes that the slump is bottoming out, it is forecasting growth in the OECD nations at 4.4% (annual rate) in first half 1976. This rate of growth would, at best, keep OECD unemployment from rising above the present 15 million.

The gloomy OECD view was reflected in decisions taken at the EC Summit meeting last week. The leaders of West Germany, France, and the Benelux countries agreed to adopt reflationary policies to stave off even greater unemployment this winter. The EC Commission is drawing up a list of fiscal options for member countries. The Nine plan to appeal to the other industrialized countries, especially Japan and the United States, to adopt more aggressive recovery programs.

The OECD noted that inventory adjustments were the key factor in the sharp decline in GNP in the major countries in first half 1975. In the United States, inventory liquidation averaged 1.9% of GNP in the first two quarters, while West German stocks also declined substantially. In Japan, Canada, and the United Kingdom, stocks have continued to grow, although at sharply reduced rates.

We expect stockbuilding in the recovery phase to be sluggish compared with previous upturns. Because of weak final demand, firms will tend to hold the line

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on stock additions at least through the end of 1975. In the past, inventory accumulation accounted for as much as one-fifth of the growth in GNP once recovery began.

Prices For All Major Food Commodities Are Up Sharply after trending down for nine months. During 1-21 July, wheat prices jumped 20% to $3.70 a bushel, and corn and soybeans rose 7% and 12%, respectively. Anticipation of large Soviet purchases spurred the advances. Coffee and sugar prices also are on the rise because of poor weather in important growing areas.

Unfavorable Weather Has Dimmed Eastern Europe's Hopes for Bumper Harvests. Torrential rains and flooding hit Romania, Yugoslavia, Hungary, and Czechoslovakia at the beginning of the harvest. Grain crops in East Germany and fodder crops in Poland are threatened by drought. We now estimate the region's grain crop at 86 million tons, compared with 90 million tons in 1974. (Confidential)

Articles

EASTERN EUROPE: ECONOMIC SITUATION REPORT

Poor crop weather in July in Eastern Europe portends a disappointing agricultural performance in 1975 and an almost certain slowdown in economic growth. The various Communist regimes had already been braced for a difficult year because of prolonged Western recession and the substantial rise in the price of Soviet raw materials.

Agriculture: Floods in the South, Drought in the North

The East European governments had been counting on a grain crop even greater than the record 90 million tons of 1974. However, rains, floods, and drought combined forces in early July to dim these hopes. With the harvest under way, torrential rains and flooding hit Romania, Yugoslavia, Hungary, and Czechoslovakia, causing considerable damage to grains. Meanwhile, grain crops in East Germany and fodder crops in Poland were threatened by drought. We have lowered our estimate of the region's grain crop to 86 million tons.

Impact of Western Recession

Recession among major non-Communist countries has held back Eastern Europe's export sales in 1975, with the decline in volume being hidden by price increases and revaluations of currencies.

Yugoslavia purchased three-fourths of its imports from the West in 1974 and, with its more open and less centrally planned economy, is particularly vulnerable to economic developments in the West. Exports to its major Western markets declined in the first quarter compared with a year earlier while imports continued to increase rapidly. Belgrade imposed import restrictions in June. It has requested debt rescheduling on a selective basis, being able so far to finance only two-thirds of the hard currency requirements we estimate for 1975. Growth of industrial production slackened in late spring as a result of earlier import restrictions and deliberate efforts to rein in new investment. In spite of government efforts to curb imports and investment, inflation is still running at 25%. A unique factor in the inflation problem in Yugoslavia is the ability of local worker councils to press for higher wages.

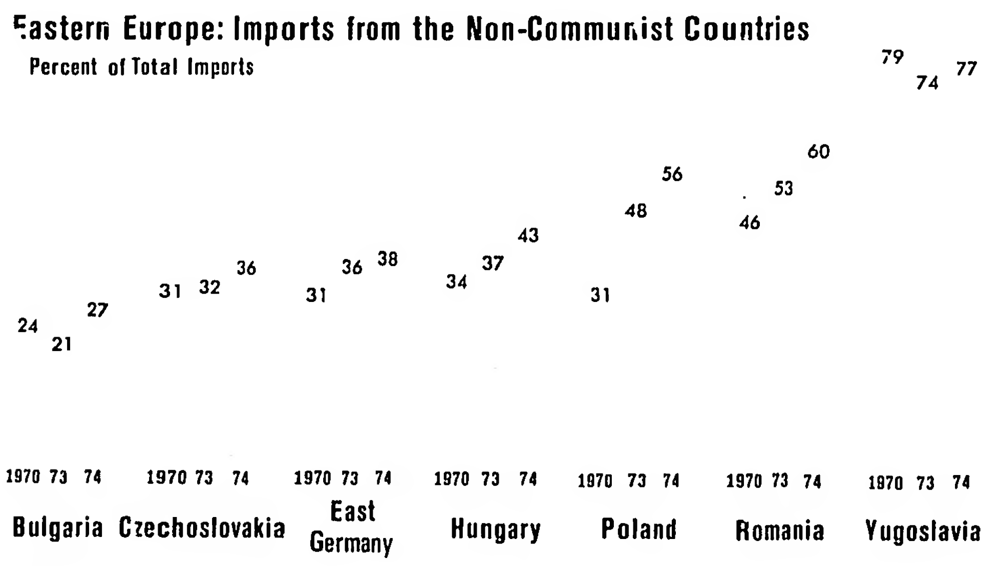
Romania, as an exporter of petroleum and a beneficiary of higher world prices, continued its rapid industrial growth through the first quarter. Growth of exports to the West was about the same as in 1974 but, like the others, Romania was

having difficulty in marketing such goods as textiles and chemicals in the West. Also, Romania is no longer self-sufficient in crude oil and will require increasing imports to utilize its refining capacity. Bucharest in July imposed price increases for various consumer goods and services, ranging from 25% for natural gas to 103% for heating oil.

Poland, with the advantage of growing foreign demand for raw materials such as coal and sulfur, has been less affected than the others by world economic problems. Prices for its exports to the West actually increased more in 1974 than prices for its imports. Warsaw is having little difficulty in obtaining Western credits, having secured at least $2.6 billion so far in 1975. The largest deal is the $1.7 billion in government-guaranteed credits from France arranged during Giscard D'Estaing's visit to Warsaw in June. The regime is still managing to satisfy consumer demand sufficiently to avoid widespread discontent. Adverse consumer reaction to scattered meat shortages last winter and again in June underline the continuing pressure on the regime to step up supplies of quality goods.

Hungary, which purchased less than half of its imports from the West in 1974, already has lowered its goals for economic growth and levels of consumption for the next five years. Poor in mineral resources, Hungary is more heavily dependent on trade for its economic progress than are the other East European countries. Exports to the West declined in the first quarter and continued to decline in April and May. The government has been tightening restrictions on imports. Hungary was the only East European country to reduce orders for Western machinery and equipment in January-May 1975 compared with a year earlier.

Bulgaria, *Czechoslovakia*, and *East Germany* are less dependent on Western imports and have generally been less affected by the recession.



Eastern Europe: Trade with the West[1]

Million US $

	Imports				Exports			
	1973	1974	Jan-Mar 1974	Jan-Mar 1975[2]	1973	1974	Jan-Mar 1974	Jan-Mar 1975[2]
Total	**10,521**	**15,311**	**3,080**	**4,421**	**7,828**	**9,485**	**2,110**	**2,337**
Bulgaria	408	717	122	243	299	325	83	89
Czechoslovakia	1,118	1,417	289	385	963	1,139	238	299
East Germany	1,580	2,020	414	559	1,413	1,819	396	457
Hungary	929	1,526	308	461	939	1,115	235	233
Poland	2,605	3,723	778	1,084	1,589	2,029	489	543
Romania	1,164	1,809	362	581	919	1,187	237	306
Yugoslavia	2,717	4,099	807	1,108	1,706	1,871	432	410

1. Austria, France, Italy, Japan, Sweden, Switzerland, United Kingdom, United States, and West Germany. Data are from Western sources.
2. Preliminary estimates.

Eastern Europe: Trade with the United States[1]

Million US $

	Imports				Exports			
	1973	1974	Jan-Mar 1974	Jan-Mar 1975	1973	1974	Jan-Mar 1974	Jan-Mar 1975
Total	**839**	**1,130**	**302**	**374**	**471**	**807**	**178**	**192**
Bulgaria	6	22	2	11	5	8	6	9
Czechoslovakia	72	49	13	12	35	46	8	11
East Germany	28	21	6	2	10	14	3	3
Hungary	33	56	20	30	16	75	7	13
Poland	349	395	104	141	182	266	68	69
Romania	116	277	72	74	56	130	28	18
Yugoslavia	235	310	85	104	167	268	58	69

1. US data.

Trade with the United States is dominated by Poland and Yugoslavia, the only countries having Export-Import Bank financing and most-favored-nation status. Romania found its access to Export-Import credits suspended under the 1974 US Trade Act; a Romanian-US trade agreement now awaits legislative action in the Congress.

The Soviet Price Increases

The stiff price increases for Soviet oil and other raw materials in early 1975 have had their greatest impact on Hungary, Czechoslovakia, and East Germany. Poland with its coal and Romania with its oil have been less affected. Bulgaria has fallen in between. Yugoslavia had been paying world market prices for its Soviet raw materials and has not been affected by the price hikes. The impact on the hardest hit countries has been mitigated – at least in 1975 – by various Soviet concessions. For instance, the Hungarians have benefited from Soviet long-term credits and above-plan deliveries of vital raw materials.

Near-Term Prospects

We expect the East European regimes to search for additional financing in Western money markets while dampening consumption at home. Indebtedness to the West is high and growing, although not yet a serious problem (except in Yugoslavia). Poland alone may avoid an economic slowdown this year. (Confidential)■

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IRAQ: THE WEAK LINK IN OPEC?

We see little political or economic basis for press assertions that Iraq is becoming the weak link in OPEC. Iraq's differences with the other producing states in the past – most notably during the 1973 war when Baghdad refused to go along with OAPEC-ordered production cuts – have now been largely submerged. Its large population and pressing economic needs – the main focus of press reports – can be provided for within the OPEC framework. The benefits of oil-producer solidarity outweigh any gain that might come from price cuts designed to increase Baghdad's market share.

Changing Economic Status

Although Iraq has more economic potential than most Gulf countries and a greater capacity to absorb inputs of foreign capital, manpower, and management, a lack of foreign exchange severely hampered development through 1972. Oil production and exports stagnated in the 1960s and early 1970s because of an extended dispute with international oil companies. However, the quadrupling of oil prices in 1973-74 has given Baghdad large additional resources to devote to development. Oil revenues reached $6.6 billion in 1974, more than five times the 1972 level.

Future Development Needs and Oil Revenues

Baghdad plans to accelerate the already rapid pace of development outlays. In the final nine months of 1975, the government plans to spend $3.3 billion for development – 10 times the allocations of the early 1970s. A five-year plan to start in 1976 has targeted total expenditures of $34 billion.

We see no financial impediments to these development plans. Iraq could achieve its goals at the current output level of about 2.3 million barrels a day with no increase in the price of oil. If prices rise, as seems certain, the financing will be easier.

Iraq will almost certainly run into practical difficulties in spending $34 billion in five years. Total imports for all needs including development were only about $2.6 billion in 1974 and $900 million in 1973. Even these import levels – far below those required by the new plan – sorely strained port and transportation facilities. Moreover, Iraq lacks the infrastructure and the skilled manpower to make rapid use of the funds now available for development. These physical limits on

spending have led to a large foreign exchange surplus. In 1974, reserves rose from $1.6 billion to $3.3 billion.

Growing Cooperation Within OPEC

Iraq, while continuing to seek a larger share of the world oil market, is putting first priority on normalization of relations with other OPEC members. Baghdad is expanding contacts with Saudi Arabia and other moderate Arab states, and it has recently mended political fences with its longstanding enemy, Iran. In June, Iraq announced a scaling down of the 1980 production goal – from more than 6 million b/d to 4 million – in a well publicized gesture of support for OPEC price and production policies. We believe that Iraq will continue to avoid behavior that could threaten the cartel's pricing policies. (Confidential)■

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Note

USSR: Drought Spurs Orders

Drought persists in most of the Soviet grain area. During the first 10 days of July, rain fell in the southern Ukraine and the Volga Valley but not enough to substantially improve crop conditions. Subsequently, a high-pressure system centered in the Baltics has kept most of the grain lands dry. The cumulative impact of the hot, dry weather of the past seven weeks dictates a further reduction in our estimate of Soviet grain output for 1975 – to below 200 million tons. Poor crop prospects have induced Moscow to buy about 12 million tons of wheat, corn, and barley, largely from the United States and Canada for delivery in FY 1976. A new round is likely if crop prospects deteriorate further. (Confidential)

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Foreword

The *Economic Indicators* provide up-to-date information on changes in the domestic and external economic activities of the major non-Communist developed countries. To the extent possible, the *Economic Indicators* are updated from press ticker and Embassy reporting, so that the results are made available to the reader weeks - or sometimes months - before receipt of official statistical publications.

Comments and queries regarding the *Economic Indicators* are welcomed. They may be directed to [redacted] the Office of Economic Research, Code 143, Extension 7402 or 351-7402. 25X1A

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